Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
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ANALYZING PROFITABILITY, BY FIRM CATEGORY: 1983 AND 1H 1984

HIGHLIGHTS

1. After-tax ROE declined in 1983 for both National Full-Line and Large Investment Banking firms but rose for N.Y. Based Regionals and Regional firms. Profit margins declined for the former two firm categories while rising for the latter ones. In 1H 1984, National Full-Line firms experienced a loss while other firm categories remained profitable although at lower levels. In fact, Regional firms were barely profitable during the 1H 1984.

2. The industry trend of increasing importance of trading profits and decreasing importance of commission revenues continued in 1983 for N.Y. Based Regionals but was reversed for National Full-Line firms. Commission revenues grew at a faster rate for the Large Investment Banks in 1983 than most other firm categories, reflecting their stress on institutional business. In 1H 1984, only the Large Investment Banks enjoyed increased total revenues as revenues shrank for other segments of the securities industry.

3. Cost containment programs were more evident among some firm categories than others as profitability fell in 2H 1983 and in the difficult 1H 1984 period. Overall, controls over expenses were more successful for N.Y. Based Regionals and Regional firms than National Full-Line and Large Investment Banking firms.

4. During 1983, concentration in total revenues and capital lessened in the securities industry. Declining concentration in commission revenues and capital continued in 1H 1984, while concentration in total revenues rose.

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Introduction

This Trends report is Part II of a two part issue reviewing the securities industry's performance in 1983 and 1H 1984. Part II analyzes profitability, revenues, and expenses, by firm category. The firm categories examined are National Full-Line, Large Investment Banks, Regional and New York Based Regional. In addition, trends in concentration are discussed.

The industry's performance for 1983 and 1Q 1984 were presented in Part I, the July Trends issue. Also included was an analysis of discounters' profitability and market share. Industry profitability reached record levels during the 1H 1983 but over the next four quarters, higher interest rates caused net income to plummet because of adverse effects on revenues and expenses. As a result, pre-tax annualized ROE dropped from 57% in 1H 1983 to 19% in 2H 1983 and 7% for 1H 1984 (for a detailed summary of revenues and expenses in 1983 see Tables 1 and 2). Recently, published 2Q 1984 data revealed that the industry suffered a loss of $98 million, the first quarterly loss since 4Q 1978 (-$11 million).

Profitability

For the securities industry, after-tax return on equity (ROE) declined slightly in 1983 to 19.8% from 21.9% in 1982. This decline was due to a small drop in profit margin, and a larger fall in asset turnover.1/ Industry leverage increased slightly in 1983. Two firm categories -- National Full-Line (NFL) and Large Investment Banks (LIB) -- followed the industry trend. ROE declined for the NFL firms from 16.1% in 1982 to 15.2% in 1983, and for the LIBs from 29.6% to 23.7% (Table 3). In both cases, the decline was due to a small fall in profit margins and a significant plunge in asset turnover (Table 4).

1/ Profit margin (pre-tax earnings per dollar of revenue) times asset turnover (revenues per dollar of average assets) times leverage (average assets per dollar of average equity) times the tax retention rate (1 minus tax rate on industry) equals after tax earnings per dollar of average equity (ROE).

Table 1

Securities Industry Revenues, Total Expenses And Net Income
(millions of dollars and % of total revenues)

	1983		1H 1984	
	Dollars	% of Total	Dollars	% of Total
REVENUES*				
Commissions				
Listed Equities on an Exchange	$6,129.7	20.7%	$2,665.0	18.6%
Listed Equities Executed OTC	112.3	0.4	35.5	0.2
Listed Options	796.6	2.7	406.0	2.8
Other	1,304.1	4.4	510.5	3.5
Total	8,342.9	28.2	3,617.0	25.2
Trading Profits				
Market Making OTC	1,380.9	4.7	428.9	3.0
Debt Securities	4,417.8	15.0	2,163.6	15.1
Options on Nat'l Exchange	63.6	0.2	31.7	0.2
Other	981.3	3.3	509.3	3.5
Total	6,838.8	23.1	3,130.7	21.8
Investment Profits				
Realized	495.7	1.7	346.6	2.4
Unrealized	178.0	0.6	(106.4)	(0.7)
Total	742.9	2.5	240.3	1.7
Underwriting				
Equity Securities	754.2	2.6	128.9	0.9
Total	3,536.7	12.0	1,175.8	8.2
Margin Interest	2,125.5	7.2	1,450.8	10.1
Mutual Fund Sales	952.0	3.2	343.2	2.4
Account Supervision	569.6	1.9	308.8	2.1
Research	18.7	0.1	9.9	0.1
Commodities	826.1	2.8	410.7	2.9
Other-Related	4,384.1	14.8	2,888.7	20.1
Other-Unrelated	1,207.6	4.1	790.4	5.5
TOTAL REVENUES	$29,544.9	100.0%	$14,366.0	100.0%
TOTAL EXPENSES	$25,721.6		$13,952.9	
PRE-TAX NET INCOME	$3,824.6		$412.9	

( ) Negative

* Discrepencies may exist due to rounding.

Source: Securities Industry Database

Table 2

Securities Industry Expense Breakdown
(millions of dollars and % of total revenues)

	1983		1H 1984	
	Dollars	% of Total Revenues	Dollars	% of Total Revenues
EXPENSES*				
Registered Rep. Comp.	$5,748.3	19.5%	$2,495.1	17.4%
Clerical & Admin.	4,887.6	16.5	2,494.3	17.4
Partners' & Stock.	983.1	3.3	435.0	3.0
Other Employee Comp.	448.5	1.5	213.9	1.5
Floor Brokerage & Clearance	1,142.2	3.9	585.8	4.1
Fl. Brok.-Brokers	389.9	1.3	205.4	1.4
Comm. & Clear.-Others	390.2	1.3	196.1	1.4
Clear. Pd. Non-Brokers	246.4	0.8	128.0	0.9
Comm. Pd.-Other Brokers	115.8	0.4	56.3	0.4
Communications	1,536.7	5.2	878.6	6.1
Occupancy & Equipment	1,137.1	3.8	709.5	4.9
Promotional Costs	734.4	2.5	387.6	2.7
Interest	6,050.6	20.5	4,290.3	29.9
Error Accts. & Bad Debts	232.6	0.8	107.1	0.7
EDP Equipment Costs	342.2	1.2	202.3	1.4
Non-recurring charges	98.5	0.3	3.9	0.0
Regulatory Fees & Exp.	133.7	0.5	69.7	0.5
Other	$2,249.0	7.6	1,080.0	7.5
TOTAL EXPENSES	$25,721.6	87.1%	$13,952.9	97.1%

* Discrepancies may exist due to rounding.

Source: Securities Industry Database

Table 3

After-Tax Return on Equity (ROE)

	1982	1983	Annualized 1H 1983	Annualized 2H 1983	Annualized 1H 1984
National Full-Line	16.1%	15.2%	30.8%	1.4%	(9.8)%*
Large Investment Banks	29.6	23.7	29.3	18.7	13.2
N.Y. Based Regionals	23.4	27.3	34.4	21.7	11.0
Regionals	19.4	21.9	31.8	13.0	1.5
Industry	21.9	19.8	30.6	10.3	3.8

* Because of 1H 1984 loss, ROE is pre-tax.

The ROE of the N.Y. Based Regionals (NYR) and the Regionals (R) went against the industry trend in 1983, rising from 23.4% to 27.3% and 19.4% to 21.9%, respectively. In the case of the NYRs, virtually all of the increase was due to a substantial improvement in profit margin (14% in 1982 and 18.3% in 1983), with asset turnover nearly unchanged from 1982.

Table 4

Component Analysis of After-Tax Return on Equity

		Profit Margin ($)	x	Asset Turnover ($)	x	Leverage	x	Tax Retention Rate (%)	=	ROE (%)
Nat'l Full Line	1982	.0881		.2681		12.6		54.0%		16.1%
	1983	.0858		.2400		13.7		54.0		15.2
Lg. Invst. Bks.	1982	.1736		.1045		30.2		54.0		29.6
	1983	.1673		.0872		30.0		54.0		23.7
New York Based	1982	.1403		.2257		13.7		54.0		23.4
	1983	.1834		.2267		12.2		54.0		27.3
Regionals	1982	.1108		.3439		9.4		54.0		19.4
	1983	.1265		.4083		7.8		54.0		21.9
Industry	1982	.1308		.1787		17.3		54.0		21.9
	1983	.1294		.1631		17.3		54.0		19.8

Asset turnover rose dramatically for the Rs, from $0.34 of revenue generated per dollar of average assets in 1982 to $0.41 in 1983. Profit margin also rose slightly, from 11.1% to 12.7%. However, offsetting these trends was a decline in leverage (9.4 to 7.8).

ROE deteriorated in 2H 1983 for different reasons for the various firm categories. For the LIBs and NYRs, revenue continued to increase in 2H 1983, but so did expenses -- by about twice as much. For the NFLs, revenues declined in 2H 1983 by $800 million while expenses rose by $200 million. Revenues also declined substantially for the Rs by $170 million, while expenses were nearly unchanged. Nevertheless, average equity continued to rise in 2H 1983 for each firm category. For NFLs, LIBs and Rs, average equity increased by 12.6% - 13.7%; for the NYRs, an impressive 21%.

Revenues

National Full-Line (NFL)

Commissions -- the largest revenue source for the NFL firms -- rose by 35% to $3.6 billion in 1983 reflecting substantial increases in equity prices and volume (Table 5). The spurt in commissions increased the relative importance of this revenue source, reversing a declining trend. During the three year period 1980-1982, commissions as a percentage of gross revenue plunged from over 37% to slightly more than 27%. In 1H 1984, commission revenues fell on an annualized basis by 18.3% from the 1983 level as a result of declines in equity prices and less retail activity. By 1H 1984, the AMEX Market Value Index had declined 10.3% from year-end 1983, the NASDAQ Composite 14% and the S&P 500, 7%.

Table 5

National Full-Line

Revenue Sources
(millions of dollars)

			% Change	
	1983	1H 1984	1983/1982	Annualized 1H 1984/1983
Commissions	$3,628.7	$1,481.8	34.6%	(18.3)%
Trading Profits	2,891.8	1,278.7	26.8	(11.6)
Underwriting	1,592.9	595.8	26.9	(25.2)
Margin Interest	1,100.5	770.2	2.3	40.0
Other-Related	1,524.5	892.1	30.3	17.0
Other-Unrelated	316.0	211.5	(15.9)	33.9
All Other	1,868.7	730.1	99.2	(21.9)
Total	$12,923.1	$5,960.2	30.7%	(7.8)%

Although trading profits rose in 1983 by 26.8%, as a percentage of gross revenue, trading profits declined from 23.1% in 1982 to 22.4% in 1983. This reversed earlier trends where the relative importance of trading profits increased. The flux in revenue sources is evident by this: commissions exceeded trading profits as a percentage of gross revenue by only 4 percentage points in 1982; in 1980, this difference was over 20 percentage points. For the industry, the gap of 15 percentage points between these two revenue sources in 1980 (commissions provided 35% and trading profits 20% of gross revenues) narrowed in 1981 and virtually disappeared in 1982.

Because of interest rate trends in 1982 and 1983, trading profits on debt securities for NFLs increased only 7.4% from 1982 levels. Nearly two-thirds of the $612 million increase in trading profits came from OTC market making. During the 1H 1984, trading profits, on an annualized basis, declined by 11.6% as a result of a continuous rise in interest rates.

Underwriting revenues rose by nearly 27% in 1983 to $1.6 billion, with revenue from equity securities increasing by 83.5% as NFL firms participated in the huge increase in common stock offerings, particularly IPOs. Revenues from debt securities rose nearly 20% due to increased offerings of certain securities -- mortgage backed securities, zero coupon bonds, etc. In 1H 1984, underwriting revenues dropped dramatically -- by 25.2% -- as aggregate corporate equity and debt offerings declined on an annualized basis to $84 billion from $102 billion in 1983, or 18%. IPOs were particularly depressed by falling equity prices, declining 30% and 65% in number and value, respectively.

Margin interest revenues increased slightly (2.3%) in 1983. In prior years (1979-1981), they provided between 17% - 21% of gross revenues. Such revenue rose by a modest amount because of the substantial decline in rates charged customers (from 14.9% in 1982 to 11.4% in 1983),2/ though year-end NYSE customer margin debit balances rose to nearly $18 billion from $12 billion in 1982. As rates charged customers inched up in 1H 1984, margin interest revenue increased by 40% on an annualized basis.

Large Investment Banks (LIB)3/

Commission revenues -- relatively less important to the LIBs than for other firm categories -- increased by 40% in 1983 (Table 6). Commissions increased at a faster rate for LIBs than most other firm categories as institutionalization of trading continued as reflected in the growth of large block transactions (10,000 shares & over) in 1983. Such blocks rose to 45.6% of NYSE share volume from 41% in 1982. With institutional activity falling relatively less than retail activity, LIBs' commission revenues declined by only 5.7% in 1H 1984.

2/ "Securities Industry Performance: 1983 and 1H 1984," Securities Industry Trends, SIA, July 30, 1984.

3/ Data for 1982 are not presented because there was a reclassification of firms for 1983. Included are 1983 and 1H 1984 data.

Table 6

Large Investment Banks

Revenue Sources
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Commissions	$1,215.9	$ 573.5	(5.7)%
Trading Profits	2,708.2	1,337.4	(1.2)
Underwriting	1,050.6	342.5	(34.8)
Margin Interest	269.4	193.1	43.4
Other-Related	1,984.4	1,549.9	56.2
Other-Unrelated	458.1	283.9	23.9
All Other	522.6	264.9	1.4
Total	$8,209.2	$4,545.1	10.7%

Trading profits in 1983, the most important revenue source for LIBs, remained nearly identical to 1982 because of interest rate trends. As interest rates inched up in 1H 1984, trading profits declined 1.2%.

Underwriting revenue rose 73.2% in 1983, before plunging nearly 35% on an annualized basis in 1H 1984. For LIBs, underwriting activity provided nearly 13% of gross revenues in 1983.

Gross margin interest revenue rose 28.2%, far greater than the industry average of 6.3%, possibly reflecting an emphasis on additional retail accounts at certain LIBs. Other-securities related income -- interest on repos, M&A and private placement fees -- declined by 4.4% for LIBs, while increasing nearly 12% for the industry. In 1H 1984, commissions, trading profits and underwriting revenues were down, but other-related income rose by over 56%.

New York Based Regionals (NYR)[4/]

Though commission revenues increased by 41.6% in 1983 for the NYRs, their relative importance declined slightly as gross revenues jumped almost 46% (Table 7). Nevertheless, NYRs continued to derive more of their gross revenues(42%-53%, 1979-1983) from commissions than other firm categories. While commissions were declining in significance in 1983, trading

4/ Data for 1982 are not presented because there was a reclassification of firms for 1983. Included are 1983 and 1H 1984 data.

profits increased dramatically (58.7%), and continued to rise in relative importance. Last year, the spurt in trading profits was due mainly to OTC market-making activities.

Table 7

New York Based Regionals

Revenue Sources
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Commissions	$ 794.3	$342.2	(13.8)%
Trading Profits	259.4	93.5	(27.9)
Underwriting	86.9	15.3	(64.8)
Margin Interest	174.5	116.3	33.3
Other-Related	221.7	122.7	10.7
Other-Unrelated	38.4	44.8	133.3
All Other	169.3	85.5	1.0
Total	$1,744.5	$820.3	(6.0)%

Underwriting revenues have been quite volatile for NYRs. For example, underwriting revenues rose nearly 130% in 1983, but declined nearly 65% on an annualized basis in 1H 1984. Both gross margin interest revenue and other-related revenues rose about 20% in 1983, but declined 33.3% and 10.7% on an annualized basis in 1H 1984, respectively. Margin interest revenue continued to be a considerably more important revenue source for NYRs than for other firm categories because of the importance of retail business and many customers having active margin accounts.

Regionals (R)

Commission revenues rose 35.4% in 1983, slightly less than for the industry (Table 8). During 1981-1983, commissions ranged fairly consistently between 36%-39% of gross revenues as compared to 1979-1980 when they provided nearly half of all revenues. In 1H 1984, commissions were off 16% on an annualized basis.

In 1983, trading profits increased by nearly 20%, considerably higher than for the industry, reflecting Rs' greater relative participation in OTC market making activities. However, as securities prices declined in 1H 1984, trading profits, on an annualized basis, declined by 20.4%. In recent years, trading profits have inched up as a revenue source for regional firms providing 16.5% of gross revenue in 1983 after peaking at 18% in 1982.

Table 8

Regionals

Revenue Sources
(millions of dollars)

	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/1983
Commissions	$1,406.2	$ 590.5	35.4%	(16.0)%
Trading Profits	595.6	237.0	19.9	(20.4)
Underwriting	630.5	182.5	70.7	(42.1)
Margin Interest	303.9	215.4	(2.4)	41.8
Other-Related	339.5	171.0	7.9	0.7
Other-Unrelated	72.7	32.6	(3.6)	10.3
All Other	272.4	131.0	37.9	(3.8)
Total	$3,620.8	$1,560.0	29.2%	(13.8)%

Underwriting revenues rose by over 70% in 1983, a much larger increase than for the industry. This reflected Rs' participation in the surge of equity issues and IPOs. Underwriting revenues provide a greater percentage of their total revenues than for all other firm categories. Interestingly, during the 1979-1983 period, the gap between Rs and other firm categories concerning the significance of underwriting revenues widened. During 1H 1984, their underwriting revenues were off 42%, on an annualized basis.

Expenses

National Full-Line (NFL)

NFLs' total expenses in 1983 rose at a slightly faster rate than revenues as the need for cost containment programs was still not evident (Table 9). This differential would have been even greater except for lower average interest rates limiting the rise in interest expense. If interest were excluded, the differential between rising expenses and revenues was more pronounced. For example, non-interest expenses increased 33% while proximate non-interest revenues (excludes margin interest and other-related revenues) rose 30%. Naturally, this trend put pressure on profit margins.

Last year, employment expense accounted for 50% of NFL expenses and was largely responsible for the jump in total costs. Significant increases occurred in both the number of

Table 9

National Full-Line

Summary of Major Expenses
(millions of dollars)

			% Change	
	1983	1H 1984	1983/1982	Annualized 1H 1984/1983
Interest	$1,757	$1,327	20%	51%
Employment	6,078	2,814	38	(7)
Registered Rep.	3,451	1,535	41	(11)
Clerical & Admin.	2,627	1,279	34	(3)
Fixed	1,702	1,016	23	19
Communications	923	529	20	15
Occupancy & Equipment	630	394	33	25
EDP Equipment Costs	148	93	6	26
Floor Brokerage and Clearance	362	176	18	(3)
All Other	1,915	848	19	13
TOTAL EXPENSES	$11,814	$ 6,181	31%	5%
TOTAL REVENUES	12,923	5,960	30	(8)
NON-INTEREST EXPENSES	$10,057	$4,854	33%	(3)%
PROXIMATE NON-INTEREST REVENUES	9,806	4,298	30	(12)

employees and average employee compensation (Table 10). Overall, rising employment accounted for about 30% of the jump while higher compensation was responsible for 70%. Among the components, RR compensation accounted for 60% of the climb in total employment expense with 15% occurring because of an expansion in the number of RRs and nearly 45% due to higher compensation. Relative to the remaining employees (includes Non-Registered Representative Income Producing and All Other), higher employment boosted total employment expense 15% while

higher earnings caused a 25% increase.5/ It is noteworthy that employment continued rising at annual rates of 11% and 13% in 3Q 1983 and 4Q 1983, respectively, when proximate non-interest revenues and profitability were both dropping.

5/ The following methodology was used to estimate the variables responsible for the change in employment expense by type of employee: (1) number of employees and (2) average compensation.

A. For RRs

RN_2 = average number of RRs in 1982
RN_3 = average number of RRs in 1983

RC_2 = average compensation per RR in 1982
RC_3 = average compensation per RR in 1983

$\triangle EE_3$ = change in employment expense in 1983

$\frac{(RN_3 - RN_2)(RC_2)}{\triangle EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 number of RRs

$\frac{(RC_3 - RC_2)(RN_3)}{\triangle EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 RR compensation

B. All Other + Non-RR Income Producing (AO + Non-RR)

ON_2 = average number of AO + Non-RRs in 1982
ON_3 = average number of AO + Non-RRs in 1983

OC_2 = average compensation per AO + Non-RR in 1982
OC_3 = average compensation per AO + Non-RR in 1983

$\frac{(ON_3 - ON_2)(OC_2)}{\triangle EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 number of AO + Non-RRs

$\frac{(OC_3 - OC_2)(ON_3)}{\triangle EE_3}$ = percentage of 1983 change in employment expense attributable to change in 1983 AO + Non-RR compensation

Table 10

National Full-Line Firms' Employee Expense

	1982	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/83
Average Number of Employees					
Income Producing					
Registered Representative	36,695	40,565	43,270[2]	11%	7%
Non-RR	1,720	2,045	2,180[2]	19	7
	38,415	42,610	45,450	11%	7%
All Other[1]	61,915	69,965	75,820	13	8
	100,330	112,575	121,270	12%	8%
Average Compensation Per Employee					
Registered Representative	$66,820[3]	$85,075[3]	$70,925[2]	27%	(17)%
All Other + Non RR	30,705	36,480	32,795[2]	19	(10)
	$43,915	$53,990	$46,410	23%	(14)%

( ) - Negative
1 Includes clerical, administrative and other support employees.
2 Estimated by SIA.
3 These average compensations were similar to those for retail RRs which were $62,788 in 1982 and $82,926 in 1983. See: SIA, Report on Production and Earnings of RRs in 1983, p. 13.

Sources: Securities Industry Database and Securities Industry Yearbook.

Fixed expenses rose at a high rate but significantly less than total non-interest expenses. Occupancy and equipment contributed most to the increase followed by communications, while EDP equipment costs remained relatively stable.

In the 1H 1984, cost controls had still not become effective as annualized total expenses continued to rise while revenues were declining. Total expenses were 4% higher than total revenues. A 51% jump in annualized interest expense was

the major culprit for this increase. Annualized employment expenses dropped 7% in 1H 1984 as average employee compensation dropped to $46,410, 14% less than 1983.

Annualized fixed expenses continued increasing at a high rate despite the drop in revenues. EDP equipment costs climbed 26%, faster than the 1983 increase. Occupancy and equipment and communications expenses rose 25% and 15%, respectively, reflecting some improvement over 1983.

Large Investment Banks (LIB)

Profit margins deteriorated in 1983 as total expenses rose faster than revenues. This occurred largely due to the adverse impact of higher interest rates on trading profits and other revenue lines. Superficially, the 1983 rise in interest expense appears relatively modest; however, it surged 35% in the 2H 1983 while proximate non-interest revenues declined.

Non-interest expenses climbed significantly faster than proximate non-interest revenues (excludes margin interest and other-related revenues). For 1983, average employment expanded by 2,300 jobs and was responsible for over 40% of the increase in employment costs while about 60% resulted because of higher compensation.

Fixed expenses surged in 1983 and continued to rise even in the 2H 1983 despite falling revenues and profitability. Expectations of future improved business conditions, competitive factors as well as prior contractual commitments contributed to this trend. In 1983, occupancy and equipment and EDP costs each climbed about 45%, while communications rose 24%.

Annualized 1H 1984 total expenses climbed considerably more than total revenues (Table 11). However, these data may not be entirely representative because of the acquisition of Lehman Brothers by Shearson/American Express in 2Q 1984. In such a situation, expenses can escalate temporarily while revenues fall. Interest expense accounted for 90% of the rise in total expenses.

Table 11

Large Investment Banks

Summary of Major Expenses
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Interest	$3,358	$2,300	37%
Employment	1,905	962	1
Registered Rep.	857	368	(14)
Clerical & Admin.	1,048	594	13
Fixed Expenses	505	307	22
Communications	231	134	16
Occupancy & Equipment	206	132	29
EDP Equipment Costs	68	41	21
Floor Brokerage and Clearance	203	111	9
All Other	865	425	2
TOTAL EXPENSES	$6,836	$4,105	20%
TOTAL REVENUES	8,209	4,545	11
NON-INTEREST EXPENSES	$3,478	$1,806	4%
PROXIMATE NON-INTEREST REVENUE	5,956	2,802	(6)

New York Based Regionals (NYR)

Expense increases were limited during 1983 because of lower average interest rates. Expenses increased less than revenues, resulting in higher profit margins. Interest expense rose only as much as the rise in margin interest revenue and other-related revenues.

Some evidence of cost control is reflected in non-interest expenses which increased significantly less than proximate non-interest revenues. Employment expense is partially related to revenue production which helps explain why it increased faster than non-interest expenses but less than the climb in non-interest revenues.

Evidence that cost controls were in effect is seen in fixed expenses which rose at about one-half the rate of employment expenses. Communications increased least followed by occupancy and equipment and EDP equipment costs.

NYR firms remained profitable during the difficult 1H 1984 because effective cost controls were exercised. Annualized total expenses increased modestly while total revenues were falling (-6%) (Table 12). As a result, expenses as a percentage of revenues rose from 82% to 91%. Higher interest expense was responsible for about 65% of the rise in total expenses.

Table 12

New York Based Regionals

Summary of Major Expenses
(millions of dollars)

	1983	1H 1984	% Change Annualized 1H 1984/1983
Interest	$253	$165	30%
Employment	606	283	(7)
Registered Rep.	307	127	(18)
Clerical & Admin.	299	156	4
Fixed Expenses	166	91	10
Communications	74	39	7
Occupancy & Equipment	65	40	22
EDP Equipment Costs	27	12	(11)
Floor Brokerage & Clearance	141	71	0
All Other	259	136	5
TOTAL EXPENSES	$1,425	$746	5%
TOTAL REVENUES	1,745	820	(6)
NON-INTEREST EXPENSES	$1,172	$581	(1)%
PROXIMATE NON-INTEREST REVENUES	1,348	581	(14)

Regionals (R)

Rs' expense performance improved in 1983 because of strong revenue growth, lower interest rates and management controls (Table 13). Total expenses, as a percentage of total revenues, declined from 88.9% to 87.4% from 1982 to 1983. In 1983, non-interest expenses fell as a percentage of proximate non-interest revenues, from 100% to 96%. Employment expenses remained at 55% of proximate non-interest revenues. Apparently, controls were in place as average employment rose only 6% with faster growth occurring in income producing personnel.

Table 13

Regionals

Summary of Major Expenses
(millions of dollars)

	1983	1H 1984	% Change 1983/1982	% Change Annualized 1H 1984/1983
Interest	$ 295	$ 211	(5)%	43%
Employment	1,642	721	36	(12)
Registered Rep.	1,034	421	41	(19)
Clerical & Admin.	608	300	29	(2)
Fixed	453	253	21	12
Communications	236	131	17	11
Occupancy & Equipment	167	94	24	13
EDP Equipment Costs	50	28	28	14
Floor Brokerage and Clearance	174	83	28	(4)
All Other	599	275	35	(8)
TOTAL EXPENSES	$3,163	$1,543	27%	(2)%
TOTAL REVENUES	3,621	1,560	29	(14)
NON-INTEREST EXPENSES	$2,868	$1,332	31%	(7)%
PROXIMATE NON-INTEREST REVENUES	2,977	1,174	37	(21)

Cost controls enabled Rs to remain slightly profitable during the 1H 1984 despite poor business conditions which caused revenues to drop 14%. As a result, the pre-tax profit margin fell to 1% as revenues fell while expenses increased. Interest expense rose because of higher rates but this increase was limited as reliance on debt financing decreased.

Revenues from core products such as commissions and underwriting were particularly depressed in 1H 1984 with the result that non-interest expenses climbed to 114% of proximate non-interest revenues. There is reason for concern about long-term adverse effects at firms if expense reductions take place by cutting service muscle as well as fat. Rs did reduce non-interest expenses but not drastically. Annualized employment expense decreased 12% because of a 20% drop in average employee compensation.

Concentration

The expansion in the number of securities firms continued through 4Q 1983 before declining in 1H 1984. The number of NYSE firms doing a public business rose to 405 in 4Q 1983, the highest number since 1975. In the 1H 1984, the number of firms declined to 397 as business conditions deteriorated. As usual, the number of firms entering and leaving the industry reflected changes in market conditions.

During 1983, concentration, as measured by total revenues, lessened for the first time since 1979 (Table 14). It rose in the 1H 1984 with the acquisition of Lehman Brothers and the smaller number of firms. Concentration in commission revenues continued to lessen in 1983 and 1H 1984.

Table 14

Concentration Data, 1979-First Half 1984

	1979	1980	1981	1982	1983	1H 1984
Total Revenues						
Top 10	48.7%	53.1%	55.6%	57.3%	54.4%	57.0%
Top 11-25	18.6	19.4	18.7	18.7	19.6	17.4
Rest of Industry	32.7	27.5	25.8	23.9	26.0	25.6
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Commissions						
Top 10	40.0%	43.6%	43.4%	42.8%	42.0%	41.7%
Top 11-25	20.0	21.1	20.8	20.9	20.8	18.8
Rest of Industry	40.0	35.1	35.8	36.4	37.2	39.5
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total Capital						
Top 10	45.8%	50.8%	50.0%	54.8%	52.8%	54.7%
Top 11-25	18.8	18.00	19.7	18.3	18.8	16.6
Rest of Industry	35.4	31.1	30.3	26.9	28.3	28.7
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Securities Industry Database

Concentration in average capital lessened in 1983 and again in 1H 1984. Both subordinated borrowings as well as ownership equity increased at a faster rate for smaller firms than the largest 25 firms. This was attributable, in part, to differences in earnings performances as after-tax ROE was somewhat higher for the rest of the industry than the largest 25 firms during 1983 and 1H 1984. After-tax ROE in 1983 for the largest 25 firms was less than 19% compared to nearly 23% for the rest of the industry. In 1H 1984, annualized after-tax ROE was 3.5% for the former and 4.2% for the latter.

The modest decline in concentration in 1H 1984 was limited by poor business conditions which resulted in mergers and acquisitions as well as the exit of some firms from the industry. Although profitability is expected to improve somewhat in the 2H 1984, the aftermath of 1H 1984 conditions could increase concentration even more.

First Half 1984 Profitability

ROE continued to deteriorate in 1H 1984, and with the exception of the LIBs, at an accelerated rate. The ROE of the NFLs declined to a pre-tax negative 9.8% from 2.6% in 2H 1983. As in 2H 1983, revenues continued to decline and expenses to rise, but by smaller amounts. The 2H 1983 pre-tax earnings of $54 million were completely wiped out by a 1H 1984 pre-tax loss of $221 million. Still, average equity for the NFL firms rose by 7% in 1H 1984.

The ROE of the LIBs was the most resistant to the sharp industry profit deterioration experienced in 1H 1984. Their ROE declined from 18.7% in 2H 1983 to 13.2% in 1H 1984. As in 2H 1983, LIBs' revenues and expenses continued to rise. The 2H 1983 pre-tax earnings of $573 million declined to $440 million in 1H 1984, while average equity for the LIBs rose by 8.2%.

The NYRs saw their 2H 1983 ROE nearly reduced by half in 1H 1984, declining from 21.7% to 11.0%. Unlike the 2H 1983 when both revenues and expenses rose, in 1H 1984 revenues and expenses both declined. Revenues declined by $78 million and expenses by $14 million. Consequently, 2H 1983 pre-tax earnings of $138 million declined to $74 million as average equity rose by 6.3%.

In the 1H 1984, the Rs' ROE declined to 1.5% from 10.3% in 2H 1983. As in 2H 1983, revenues declined much more than expenses -- the difference being $128 million. Consequently, 2H 1983 net income of $145 million declined to $17 million in 1H 1984, while average equity for the regionals rose by 3.2%.

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SECURITIES INDUSTRY STATISTICS

VOLUME

	AUGUST 1984	YEAR-TO-DATE 1984	AUGUST 1984	YEAR-TO-DATE 1984	% CHG. Y-T-D 1984-1983
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	110.0**	92.0	74.2	85.3	7.9%
AMEX (MILS.)*	7.5	6.1	6.3	8.9	(31.5)
NASDAQ (MILS.)*	69.3	59.6	54.4	63.3	(5.8)
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	83,299**	522,246	61,555	507,164	3.0
AMEX (MILS.)	2,390	13,906	2,249	22,046	(36.9)
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,065	52,247	6,842	61,962	(15.7)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	18,474	111,612	12,203	116,992	(4.6)
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	50.4	49.9	46.7	44.1	-----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	13,338	81,310	6,801	48,668	67.1
AMEX OPTIONS	3,469	23,189	2,868	24,010	(3.4)
COMMODITY	13,201	103,621	10,826	72,382	43.2

** MONTHLY AVERAGE*

* NEW HIGH

YIELDS

(MONTHLY AVERAGES)

	AUGUST 1984	AUGUST 1983	Basis Point Change Aug. '84-Aug. '83
BOND BUYER INDEX (20 BOND)	10.7	9.7	100
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.87	12.51	36
Baa CORPORATE	14.63	13.64	99
RATIO Aaa CORPS. TO Baa CORPS.	0.88	0.92	--
MUNICIPAL BOND YIELDS (MOODY'S)	9.99	9.04	95

PRICES

(END OF MONTH)

	AUGUST 1984	AUGUST 1983	% CHANGE AUG. '84-AUG. '83
DOW JONES INDUSTRIALS	1224.38	1192.07	2.7
STANDARD & POOR'S 500	166.68	162.14	2.8
NYSE COMPOSITE	95.86	93.80	2.2
AMEX MARKET VALUE INDEX	215.41	230.14	(6.4)
VALUE LINE COMPOSITE	183.28	193.81	(5.4)
NASDAQ COMPOSITE	254.64	290.31	(12.3)

UNDERWRITING
(DOLLARS IN MILLIONS)

	AUGUST 1984	Year-to-Date 1984	AUGUST 1983	Year-to-Date 1983	% Change Aug. - Aug.	% Change 1984-1983
CORPORATE FINANCING (Gross New Issues)						
Total	11,909	59,655	6,180	74,206	92.7	(19.6)
Common Stock	1,094	6,387	3,029	28,566	(63.9)	(77.6)
# Of Common Stock Issues	52	423	156	1,064	(66.7)	(60.2)
Preferred Stock	440	2,907	460	6,678	(4.3)	(56.5)
# Of Preferred Stock Issues	9	50	7	95	28.6	(47.4)
Corporate Debt	10,375	50,361	2,691	38,963	285.5	29.3
# Of Corporate Debt Issues	70	365	43	460	62.8	(20.7)
MUNICIPAL FINANCING* (Gross New Issues)						
Total	10,581	73,009	10,677	81,756	(0.9)	(10.7)
Notes	2,106	25,089	4,101	26,097	(48.6)	(3.9)
Bonds	8,475	47,920	6,576	55,659	28.9	13.9
# of Bond Issues	433	2,971	398	4,147	8.8	(28.4)
Negotiated Bonds	6,798	34,050	4,523	39,186	50.3	(13.1)
Revenue Bonds	6,881	31,773	4,226	38,511	62.8	(17.5)

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	AUGUST 1984	Year-to-Date 1984	AUGUST 1983	Year-to-Date 1983	% Change Y-T-D 1984-1983
NET SALES	2,037.1	12,430.0	808.6	12,827.7	(3.1)%
NET PURCHASE OF COMMON STOCK	2,554.8	4,687.3	932.0	9,425.7	(50.3)
NET PURCHASE OF OTHER SECURITIES	333.6	3,532.8	136.2	1,008.0	250.5
MUTUAL FUND CASH POSITION	11.2	----	8.8	-----	-----

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	AUGUST 1984	AUGUST 1983	% CHANGE Aug. '84-Aug. '83
MARGIN DEBT OUTSTANDING ($MILS)	22,810	19,090	19.5
NET CHANGE IN MARGIN DEBT ($MILS)	3,720	7,940	(53.1)
% OF ACCOUNTS WITH EQUITY UNDER 40%	10	9	-----

UNDERWRITING
(DOLLARS IN MILLIONS)

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*Preliminary Figures

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	SECOND QUARTER 1984	Yr.-To-Date 1984	SECOND QUARTER 1983	Yr.-To-Date 1983	% Change 2nd Q.1984 2nd Q.1983	% Change 1984-1983
REVENUE						
SECURITIES COMMISSION INCOME	1,642	3,614	2,391	4,503	(31.3)	(19.7)
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	1,409	3,356	2,028	4,206	(30.5)	(20.2)
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	623	1,176	1,003	1,846	(37.9)	(36.3)
TOTAL REVENUE	6,900	14,344	7,973	15,162	(13.5)	(5.4)
TOTAL EXPENSES	6,998	13,945	6,509	12,405	7.5	12.4
NET INCOME BEFORE TAXES	(98)	399	1,464	2,757	---	(85.5)
PERCENT OF FIRMS SHOWING LOSS	50.4	40.8	12.4	9.3	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
"Greenmail: Corporate Takeover Resistance and Shareholder Rights"	Corporate merger activity has resulted in Congressional attention to greenmail. This paper describes current Congressional greenmail legislative activity, legislation and status of legislation. Also included are listings of hearing, reports and documents on greenmail.	Congressional Research Service, Library of Congress, Washington, D.C. 20540 (Order Code IB4112)
"Arbitrage Opportunities: Illusion or Reality"	Yields quoted for mortgage and Treasury securities may not be accurate because of differences in cash flow. Rules of thumb used for mortgage securities result in consistently understating the true yield spread over Treasuries for deep discount mortgage securities and overstating the true yield over Treasuries for premium securities. This article discusses these errors and the process required for investors to calculate the true spread between yields on mortgage securities and Treasury bonds.	Federal Home Loan Mortgage Corp., Secondary Mortgage Markets, August 1984
"Spotting Prepayment Premiums"	Mortgage-backed securities must pay higher yields than noncallable long-term debt instruments. Investors in the former securities must be compensated for the potential losses resulting from prepayments. Mortgage borrowers are willing to pay higher yields because of the prepayment privilege. "The amount investors require above the yield on otherwise identical noncallable securities is known as the prepayment or 'call' premium." A model is presented to calculate the value of the prepayment option.	Federal Home Loan Mortgage Corp., Secondary Mortgage Markets, August 1984
Financial Innovations	Contains papers and discussions presented at the Federal Reserve Bank of St. Louis' seventh annual economic policy conference. The focus of the conference was to examine whether innovations have contributed to or actually impaired the efficiency and stability of financial markets.	The Federal Reserve Bank of St. Louis, P.O. Box 442, St. Louis, Missouri 63166

ITEM	DESCRIPTION	SOURCE
"Tracking Japan's Deregulation"	Discussed are deregulation changes to Japan's financial system brought on by the metamorphosis in Japan's economic system. The most important actions resulting from the U.S.-Japanese agreement this summer were the liberalization of Euroyen transactions and the removal of the foreign currency swap limits for banks. However, the main component of Japan's new financial system will eventually be market interest rates. Japanese securities firms are competing for deposits and expect to succeed in this area in a deregulated invironment.	Euromoney, September 1984
"Market Share and Profitability: Is Bigger Really Better?"	Corporate strategy generally relates the degree of market share to relative profitability. This relationship was tested two ways. First, it was tested by regressing profitability against market share relative to firms' four digit SIC codes. The statistical support was so weak that strategy based on a relationship between market share and relative profitability should be used with caution. Secondly, regressions were run relating market share to performance for each of 76 industries. The relationship was not significant and nearly one-third of all industries had a negative relationship.	Business Economics October 1984
"Risk Arbitrage"	Discusses the availability of both firms' risk arbitrage research and risk arbitrage services to high commission producing brokers. How brokers use this information is also explained.	Registered Representative, October 1984